



COMMUNICATION - CONNECTION - TELECOMMUNICATIONS - SERVICE  
- CREDIBILITY - PERFORMANCE - PURPOSE - POSSIBILITY - HELP  
SCHOOLS - INTEGRITY - RURAL - LOW INCOME - SUPPORT MECHANISMS  
HEALTH CARE - CONSUMER - NEUTRAL - INTERNET - TELEPHONE



Universal Service Administrative Company  
Annual Report 2002

# USAC at a Glance

## High Cost Support Mechanism

Disbursements in billions



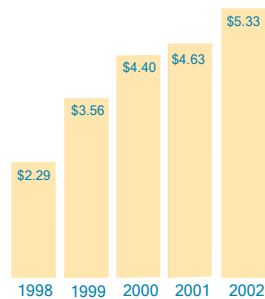
## Low Income Support Mechanism

Disbursements in millions



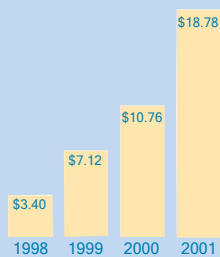
## USAC Overall

Disbursements in billions



## Rural Health Care Support Mechanism

Disbursements in millions



## Schools and Libraries Support Mechanism

Disbursements in billions



Disbursements for the Rural Health Care and Schools and Libraries Support Mechanisms are reported on this page in funding years. A funding year runs from July 1 of that year through June 30 of the following year.

USAC submits this annual report to Congress and the FCC in accordance with 47 § CFR 54.702(h), which requires USAC to report on the "operations, activities, and accomplishments for the prior year, including information about participation in each of the universal service support mechanisms and administrative action intended to prevent waste, fraud, and abuse."

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“Universal Service may well be the single most important factor in making sure our customers can actively participate in, and enjoy the benefits of, a global economy. Rural customers not only deserve, but truly need reliable and affordable advanced telecommunications services to talk to loved ones, conduct business, be entertained and basically connect with the rest of the world, which was the original intent of universal service funding. One of the key provisions of the Telecommunications Act was to strengthen existing universal service principles. Rural customers and the rest of the nation will continue to prosper from a strong universal service system that will promote investment in infrastructure and deliver advanced and affordable telecommunications services promised by the Act.”

—Nolan Moullé, Vice President of Revenues, CenturyTel

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Frank Gumper,  
Chairman of the Board



Cheryl Parrino,  
Chief Executive Officer

## Message from the Chairman and CEO

This annual report provides information regarding USAC, our customers, our performance, our and our future goals. 2002 has been a challenging year for the telecommunications industry, its investors, and all that do business with the telecommunications sector. Although USAC has faced many challenges, we have also celebrated many successes. The Universal Service Fund continues to bring access to communications technology to millions of Americans. This access has made a real difference for citizens and communities across this country.

USAC was incorporated in 1997 and was designated by the FCC as the administrator of the federal Universal Service Fund. USAC's mission is to administer the Fund and the universal service support mechanisms consistent with FCC rules in a neutral manner under close FCC regulation and oversight. The Fund changed significantly over the last year as the FCC continued to revise the universal service support mechanisms to ensure that support is explicit, sufficient, and competitively neutral as mandated by Congress. USAC has successfully implemented these changes as directed by the FCC.

USAC strives to fulfill its mission in an effective and efficient manner while

improving service to our customers. Although there were additional costs associated with implementing changes directed by the FCC, USAC's administrative expenses remain very low in comparison to non-profit corporations and government programs. In 2002, administrative expenses again were less than a penny of every dollar we collected.

USAC collects and distributes the funds for each of the four universal service support mechanisms – High Cost, Low Income, Rural Health Care, and Schools and Libraries. USAC collected over \$5.27 billion from 2,174 service providers in 2002 and disbursed over \$5.3 billion. We implemented FCC-directed changes to the billing system that eliminated the assessment of the contribution factor against universal service revenues and allowed carriers to consolidate entities for billing purposes.

USAC has a diverse stakeholder base – Congress, the FCC, telecommunications and other service providers, and telecommunications consumers nationwide. USAC strives to be responsive to all of these customers. The recipients of universal service support are also a diverse group that reaches across the geographic and economic spectrum. The number of customers

served by the various mechanisms has increased continually since USAC's creation. We measure our success in several ways: our compliance with the Communications Act and FCC rules, our responsiveness to customers, our success at maintaining program integrity, our efficiency, and in the benefits that consumers receive.

USAC has implemented significant program changes at the direction of the FCC. These changes were implemented consistent with the direction and timetables established by the FCC, which in some instances required an extremely short implementation time frame. We changed our billing system. We implemented significant changes to the High Cost Support Mechanism. We brought the new Interstate Common Line Support Mechanism for rate-of-return carriers online. We successfully disaggregated rural support consistent with the FCC's Rural Task Force Order. We changed the Schools and Libraries Support Mechanism in order to comply with a judicial ruling regarding the Children's Internet Protection Act. This required changes to FCC rules and our procedures, and required the reprocessing of many library applications.

We continually strive to improve our administrative procedures and enhance

**“We measure our success in several ways: our compliance with the Communications Act and FCC rules, our responsiveness to customers, success at maintaining program integrity, our efficiency, and in the benefits that consumers receive.”**

the information we provide to consumers. USAC now provides specific state-by-state information about the Low Income Support Mechanism. USAC has reached out to carriers in every state in order to provide more information to consumers about the Low Income Support Mechanism. We launched the Schools and Libraries Support Mechanism data retrieval tool, which provides previously unavailable, detailed information regarding all requests funded through the life of the program. We are looking for ways to provide even more information regarding the Schools and Libraries Support Mechanism to the public and to extend our data retrieval capabilities to the other support mechanisms.

USAC continued to reach out to its customers to provide training, information and, most importantly, to solicit input on how to improve customer service. Our stakeholders remain one of our best source of ideas for improvements to our administration of the support mechanisms.

Although the number and magnitude of bankruptcies filed by telecommunications companies increased significantly in 2002, and USAC continued to be a creditor in dozens of bankruptcy cases, USAC worked very hard to collect receivables from all carriers in order to

protect the integrity and stability of the fund.

Our commitment to program integrity remains deep. We take a multifaceted approach in our efforts to protect against waste, fraud, and abuse. We tightened our procedures to ensure that disbursements are accurate and are only provided to eligible recipients. We have a fully staffed internal audit division that has reviewed our procedures and conducted audits of beneficiaries and service providers. We have also engaged independent auditors to audit beneficiaries and carriers. We have established close collaborative relationships with FCC enforcement and investigative personnel and other law enforcement agencies.

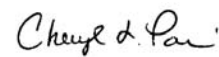
As required by FCC regulations, we engaged an independent audit firm to review USAC financial statements, our internal controls, and our operations. In 2002, the auditors again provided USAC with a clean opinion for 2001.

We anticipate that 2003 will bring even more challenges for USAC. The FCC has an unprecedented number of open dockets that relate to every aspect of the administration of universal service. These dockets include restructuring of the contribution base, the High Cost Support Mechanism, the Low Income

Support Mechanism, the Rural Health Care Support Mechanism, and the Schools and Libraries Support Mechanism.

USAC stands ready to meet these challenges. We have a dedicated and talented staff which looks forward to working closely with the FCC in 2003. We will continue to strive for efficiencies, synergies, and improvements in customer service.

The USAC Board of Directors and staff would like to thank the FCC for its support and guidance and for providing USAC with the opportunity to assist in achieving the mission of universal service.



Cheryl L. Parrino  
Chief Executive Officer



Frank J. Gumper  
Chairman of the Board



## Our Purpose

The Universal Service Administrative Company (USAC) is an independent, not-for-profit corporation regulated by the Federal Communications Commission. USAC's purpose is to ensure that all Americans receive the benefits of universal service – affordable and efficient access to telecommunications and information services.

Whether at home or at school, in the city or the country, telecommunications services are, more than ever, a matter of access for the consumer—access to communities, assistance, information, and opportunities.

Through the four support mechanisms, USAC works to make access to telecommunications services available and affordable for all Americans. Whether helping people obtain telephone service through the High Cost and Low Income Support Mechanisms, facilitating advanced telemedicine services through the Rural Health Care Support Mechanism, or helping America's schools and libraries obtain telecommunications services and Internet access through the Schools and Libraries Support Mechanism, it is that access that makes a difference in the lives of millions of Americans.

**USAC's purpose is to ensure that all Americans receive the benefits of universal service - affordable and efficient access to telecommunications and information services.**

### The Universal Service Fund

The Universal Service Fund (USF) provides the funding for the four universal service support mechanisms. The USF is funded by contributions from telecommunications companies in the United States. These companies are required to pay a specific percentage of their revenues from interstate and international revenues – the contribution factor – into the USF. The contribution factor changes quarterly

### High Cost Support Mechanism

High Cost aims to meet the goal of providing consumers in all parts of the country with affordable telephone service, regardless of where they live. Through this mechanism, rural customers can obtain telephone service at prices comparable to those paid in more densely populated areas. This \$2.98 billion mechanism has assisted over 1,500 companies serving customers in high cost areas.

### Low Income Support Mechanism

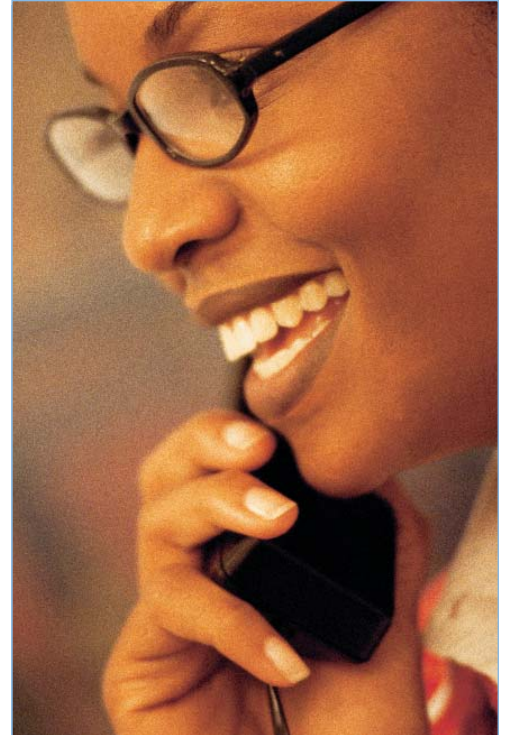
Low Income helps qualified consumers establish and maintain discounted local telephone service. In 2002, USAC distributed \$673 million to provide nearly 7 million households with discounts on the monthly and one-time costs of telephone service.

depending on the needs of the USF and the consumers it is designed to help. Because the contribution factor increases or decreases depending upon the projected needs of the USF, the amount owed by each telecommunications company will change accordingly. Different events, such as FCC regulatory action or changes in demand for support, may result in changes in the contribution factor. For example, a regulatory change that was implemented in 2002 was Interstate Common Line Support, a new component of the High Cost Support Mechanism, resulting in an increase in demand. Increased demand for a particular support mechanism may result in an increase to the contribution factor, but such increase might be offset by decreased demand for a different mechanism or a decision to credit carriers with any unused balances that remain. Funds collected in excess of disbursements are held to meet future obligations, thus reducing the amount collected.

USAC works closely with applicants and service providers to ensure that the majority of USF dol-

lars go to benefit intended recipients. Again in 2002, less than one cent of every dollar collected was used for administrative expenses, leaving the other 99 percent to provide support for applicants in the four mechanisms. Competitive bidding on all major contracts, regular audits, and tight management controls over expenditures have helped to keep USAC's administrative expenses low; this ensures that the USF is utilized to its full potential.

USAC continues to experience a significant number of bankruptcy filings from telecommunications companies that are required to contribute to the USF. We actively pursue outstanding post-bankrupt USF balances. The number of filings has more than doubled since 2000; USAC monitors bankruptcy activity and participates in bankruptcy proceedings to protect the interest of the USF. Delinquent accounts receivable represent 0.24 percent of the amount billed to carriers since 1998. USAC had a \$56,291,931.78 delinquent accounts receivable balance as of December 31, 2002.



### Rural Health Care Support Mechanism

Rural Health Care supports telecommunications costs for qualified rural health care providers, ensuring that they pay no more than their urban counterparts for comparable services.

### Schools and Libraries Support Mechanism (E-Rate)

Schools and Libraries, also known as the "E-Rate," makes advanced telecommunications affordable for the nation's schools and libraries. The E-Rate provides discounts on the costs of the services, with the highest discounts going to entities serving the most disadvantaged sections of the population.



## Our Customers

Universal service makes a difference. The unique nature of the USF means that USAC has a diverse set of customers from all over the United States and its territories. In 2002, consumers, rural health clinics, libraries, and schools benefited from over over \$5.2 billion in support distributed to service providers for telecommunications and other services. In 2002, USAC provided support to 1,515 telecommunications companies, 8,580 libraries, nearly 7 million low income households, 746 rural health care providers, and 89,157 schools. This support helped to keep the cost of telecommunications services and Internet access affordable to customers and opened up access to the World Wide Web for millions of Americans. Without universal service support, many citizens, health care facilities, libraries, and schools would pay more for their services – or in some cases, go without.

The High Cost Support Mechanism helps remote places like rural Alaska obtain telephone service at prices

comparable to the rest of the country. When the Arctic Slope Telephone Association Cooperative (ASTAC) first applied in the late 1970s to provide service to the North Slope Borough of Alaska, many of the villages had no telephones. For the villages that did have access, the one telephone for the village often resided in a shed or in an entryway to a building.

With 92,000 square miles in the region and just over 6,000 access lines, ASTAC must cover vast distances in order to provide service. The actual cost of providing telephone service to Barter Island is approximately \$100 per month, a cost that could easily become prohibitive to all but a few consumers. High Cost funding allows Arctic Slope to provide local telephone service to its customers for only \$15.30 per month.

ASTAC's goal is to expand opportunities to the North Slope region by providing, improving, and expanding competitively-priced, high-quality, and reliable telecommunications. From having no village telephones 25 years ago, residents of North Slope now have access to the same state-of-the-art calling features that urban residents have long taken for granted.

The Low Income Support Mechanism has benefited customers served by companies like Cap Rock Telephone Cooperative, which provides service to the rural western area of Texas. Its 5,200 subscribers, spread out over 4,800 square miles, are mostly from the surrounding farming communities, with about 65 percent of its subscribers over the

**“In our central Washington area, our mental health services are not at the level we would like to have them...with our population, we don't have quite as many mental health professionals as we may need. The telehealth network provides an opportunity for physicians from Spokane to consult with patients.”**

**Allen Beach  
Columbia Basin Hospital  
Grant County, Washington**



age of 65. “With the agricultural base and the age of our customers, most of them are on fixed incomes,” said Lisa Martin, a customer service representative for Cap Rock. “Lifeline has provided the opportunity for those rural customers to have a telephone in case of an emergency, or to be able to talk to someone, or just for peace of mind,” said Ricky Martinez, Cap Rock’s public affairs coordinator. “When we look at our customer base, and the savings they get from the basic cost, they can use that money for food or clothing – some of the necessities that they would otherwise give up in order to have a telephone. Lifeline provides [support] so that they do not have to make that choice between telephone and those necessities.”

Martinez also explained the necessity of having a telephone for some of Cap Rock’s customers. “The area we serve has a lot of ranch lands where the only means of communication for miles is the telephone – the nearest neighbor would be two or three miles away, easily. Telephone is definitely their peace of mind when they come home at night or go to sleep. For the people that qualify for this, the benefit is outstanding.”

Funding from the Rural Health Care Support Mechanism assists Public Hospital District #3 in Grant County, Washington by providing increased access to specialized medical resources. The network was established to provide small rural hospitals with access to information and to allow them to share resources.

“In our central Washington area, our mental health services are not at the level we would like to have them...with our population, we don’t have quite as many mental

health professionals as we may need. The telehealth network provides an opportunity for physicians from Spokane to consult with patients,” said Allen Beach, the administrator of Columbia Basin Hospital and superintendent of the district. The network, with over 35 hospitals connected, will soon also provide dermatology and cardiology consultations and follow-ups from Spokane, over 100 miles away. In addition to increased access to services, the telehealth network has allowed for expanded educational opportunities for the medical personnel, as well as enabling them to participate in various state health initiatives.

“Before this network was in place, we just couldn’t provide the education, or we’d have to select just one or two individuals and send them to conferences. Consultations would require a physician to drive for two hours each way, which meant that they had to take time away from their practices,” said Beach.

Another universal service success story is in Chickasaw County, Mississippi, a rural area with only 2,900 residents. With a per-capita income far below the national average and an average education level of 10th grade, educating the county’s young people poses numerous challenges. Seventy-two percent of the district’s 540 K-12 students qualify for free or reduced-price lunches.

Chickasaw combined Schools and Libraries Support Mechanism funding with a grant that provided literacy software for pre-kindergarten to second-grade children, allowing the district to maximize the funding available to them. “They’ve benefited from the technology,” said Ginger McClain, business manager and technology coordinator for the



**“Lifeline has provided the opportunity for those rural customers to have a telephone in case of an emergency, or to be able to talk to someone, or just for peace of mind.”**

**Ricky Martinez  
Cap Rock Telephone  
Cooperative  
Spur, Texas**

district. In the most recent round of state testing, Chickasaw’s second-graders all attained ratings of “proficient” or “advanced” in reading and math, the highest scores available. These children are the first class in Chickasaw to have had the literacy program for three years. The third and fourth-graders, who used the program for less time, also attained higher than average scores. “Before, it was a struggle just to stay average,” said Kathy Davis, superintendent of Chickasaw. “We were able to do a lot of things that we wouldn’t have been able to do without E-Rate. We just wouldn’t have had the money.”



Schoolchildren in Chickasaw County School District. Photo courtesy of Nate Hewett, Synergetics DCS, Inc.

## Our Performance

USAC works hard to keep our many stakeholders informed of new developments. We conduct outreach in various ways to keep existing customers informed and identify new participants. Through mailings to applicants and companies, attendance at association meetings, outreach conference calls, customer service, and workshops, USAC is continually in touch with telecommunications companies, other service providers, applicants, and customers to provide them with the information they need in order to take advantage of the benefits available from the USF.

### [universalservice.org](http://universalservice.org)

USAC's website is the centerpiece of its outreach and customer service. Applicants, service providers, and interested parties can find all the information they need there to participate in any of the four support mechanisms, including overviews, participation information, application forms, and announcements. For the Rural Health Care and Schools and Libraries Support Mechanisms, the website is an essential part of the application process, as both programs permit online submission of most program forms. In 2002, we enhanced the online options in order to allow applicants to electronically certify some forms.

In July 2002, the Schools and Libraries Division launched a data retrieval tool in order to provide the public with expanded data on the E-Rate. This tool allows the user to search for individual or group application information using different criteria, and provides information from the forms submitted for those groups. The tool provides valuable information to applicants, service providers, and others interested in analyzing E-Rate data.

Both the Rural Health Care Division

and the Schools and Libraries Division recently implemented new features to streamline the application process. The Schools and Libraries Division now has three of its forms available for both electronic filing and e-certification, while the Rural Health Care Division enabled electronic certification for two key forms in its application process. These options allow applicants to go to the USAC website and submit the forms electronically without the need to print out the form, sign it, and send it. In addition, Rural Health Care Support Mechanism applicants who utilize this option also have much of the form pre-populated with their information, which not only reduces errors but also makes the process easier for the applicant. Both divisions plan on implementing electronic certification for all of the forms in their application processes in the coming year.

### High Cost

The FCC created a new component of the High Cost Support Mechanism which USAC implemented in July 2002. Interstate Common Line Support (ICLS) offsets high interstate loop costs paid by end-users and interexchange carriers to rate-of-return telecommunications carriers. The mechanism mainly benefits rural telephone companies with a smaller customer base and higher operating costs. ICLS is passed on to the customers of these companies in various forms – for example, through lower monthly charges or improved service quality.

Additionally, the High Cost and Low Income Division (HCLID) oversaw the successful implementation of “disaggregation” for the components of the High Cost Support Mechanism that provide support to rural carriers. Disaggregation allows carriers to target the highest-cost portions of their

“study areas” that need the most support from the High Cost Support Mechanism. Historically, High Cost support for rural carriers was averaged across all lines served by a carrier within its study area.

Consequently, support on a per-line basis was the same throughout a study area even though the costs of serving customers within that study area likely varied. Disaggregating this support strikes a balance between rural carriers’ needs for flexibility and the FCC’s goal of encouraging competitive entry.

In order to inform its customers, HCLID focused its outreach efforts on rate-of-return carriers who would be receiving ICLS, keeping them informed of changes to the mechanism or deadlines. A workshop for carriers and subsequent meetings ensured that these groups had input on the development of the forms that they would eventually be required to submit to participate in the mechanism. For disaggregation, HCLID conducted outreach to all 1,400 carriers receiving High Cost support.

### Low Income

HCLID continually works to identify consumers who can potentially benefit from the Low Income Support Mechanism. During 2002, HCLID targeted its outreach efforts at low-income residents of tribal lands who may be eligible for enhanced Lifeline and Link Up support under the FCC’s rules. USAC’s tribal outreach efforts complement our work with the National Association of Regulatory Utility Commissioners and state public utility commissions to target low-income consumers.

In May 2002, HCLID added [www.lifelinesupport.org](http://www.lifelinesupport.org), a new, consumer-oriented feature, to the USAC website. This website provides the specific information consumers need

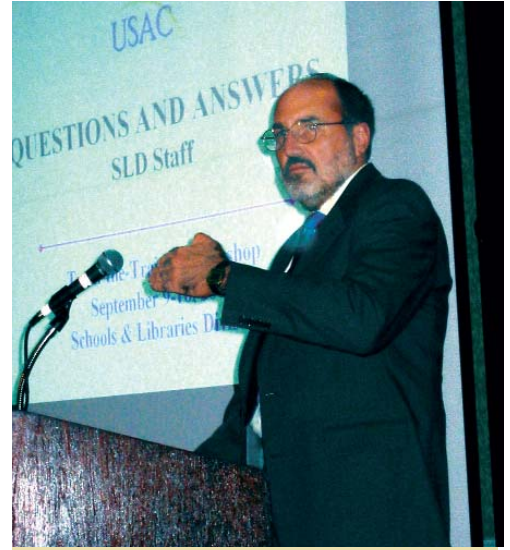
to know to determine whether they are eligible for support and, if so, how much of a discount is available. HCLID will begin an outreach campaign targeted at social service organizations nationwide in early 2003 to make them aware of the program and the information available on the website.

### Rural Health Care

USAC’s Rural Health Care Division (RHCD) conducts extensive outreach and public education to inform the rural health care community of the available benefits of the support mechanism. It focuses on underserved and low-participation areas by conducting outreach calls to various groups, and attending relevant association meetings and conferences in order to increase awareness of the Rural Health Care Support Mechanism. RHCD hosts regular conference calls for service providers and applicants in an effort to communicate new developments to these groups and to answer questions anyone may have about the mechanism. RHCD also conducts informal conference calls with potential stakeholder groups to educate them about the mechanism.

### Schools and Libraries

The Schools and Libraries Division (SLD) conducts regular conference calls with various applicant groups and service providers to keep them informed of developments in the support mechanism. “Train-the-Trainer” workshops for applicants as well as service provider training conferences were held in 2002 were attended by hundreds of representatives on behalf of 44 states, the District of Columbia, and two U.S. territories. In addition, for those who could not attend the Train-the-Trainer workshops, a webcast of the event was made available on the USAC website.



Schools and Libraries Vice-President George McDonald at the SLD Train-the-Trainers session.

As a result of an FCC ruling in June 2002 that removed a requirement from libraries receiving E-Rate funds to filter Internet content, SLD conducted a targeted outreach effort to ensure that libraries remained informed of resulting changes in requirements. Later, when the FCC clarified how libraries are to calculate their E-Rate discounts, SLD launched another major outreach effort to spread that information.

USAC contracted with the National Exchange Carrier Association (NECA) for certain support services necessary to administer the four support mechanisms. NECA has performed the tasks associated with the contract in a fully satisfactory manner. USAC also contracted with Pricewaterhouse Coopers Consulting, which in 2002 was acquired by IBM Consulting, to provide billing, collections, and disbursement services. In addition, the High Cost Support Mechanism has contracted with Rhoads and Sinon, LLC for additional High Cost support services. These contractors performed the tasks in a fully satisfactory manner.



## Our Credibility

USAC follows strict policies and procedures to ensure that the USF is administered and utilized in accordance with the Communications Act and all applicable FCC regulations. USAC is dedicated to maintaining the integrity of the USF.

The USF is subject to independent audits by the FCC and by independent auditors retained by USAC as required by FCC regulations. The USF is reported in the FCC's financial statements and is audited by the FCC. In addition, USAC's financial statements and internal procedures are audited and reviewed annually by an independent accounting firm; in 2002, the firm provided USAC with a clean opinion for its 2001 financial statements. The 2001 audit report is included as Appendix A to this report. The 2002 financial statements are in process and will be included in the 2003 annual report. USAC's Internal Audit Division also periodically reviews USAC's financial operations.

Each support mechanism is subject to both internal and external audits of its operations, procedures, and financial operations each year. In addition, each year a selection of service providers who receive High Cost and Low Income support undergo eligibility audits to determine whether the service providers are qualified to receive support and whether the amounts distributed are appropriate. For the Rural Health Care and Schools and Libraries Support Mechanisms, a sampling of applicants that received funding are sub-

ject to vigorous beneficiary reviews. During these reviews, which usually include site visits, virtually every step of the process in requesting and obtaining funds is reviewed. Fifty percent of the 25 largest recipients of E-Rate funds have been audited, representing 30 percent of the total Schools and Libraries funds disbursed. In addition, USAC has devoted significant Internal Audit Division support to Schools and Libraries Support Mechanism issues.

These audits supplement USAC's extensive program integrity assurance procedures that are designed to prevent waste, fraud, and abuse. Applications to the Schools and Libraries and Rural Health Care Support Mechanisms undergo extensive scrutiny during processing. Large and high-risk applications are subjected to special in-depth analysis by the SLD, with an in-house team including attorneys and investigators assisting in those reviews. Invoices sent to the Schools and Libraries and Rural Health Care Divisions are carefully scrutinized and modified as appropriate.

Entities that receive universal service support are subject to audits to ensure compliance with the certification requirements set forth in FCC regulations. Such audits test whether the participant is eligible to receive support, whether the rates charged comply with applicable laws and regulations, and whether the services are installed and being used for purposes allowed under the rules. These com-

**USAC follows strict policies and procedures to ensure that the USF is administered and utilized in accordance with the Communications Act and all applicable FCC regulations. USAC is dedicated to maintaining the integrity of the USF.**

pliance audits of participants are not expressly required by FCC regulations; however, the USAC Board of Directors decided, based on the recommendation of staff, that audits of program beneficiaries are an essential component of internal control. Subsequently, portions of the beneficiary audits have been incorporated into the audits of internal controls and operations. In 2002, USAC spent \$1,065,380 on audits performed by independent audit firms.

USAC has increased its Internal Audit Division from two to seven staff members, expanding our audit and oversight capabilities. Two of these auditors are certified fraud examiners. The Internal Audit Division also employs a certified information systems auditor, a certified internal auditor, and two certified public accountants. This expansion has allowed greater oversight over all four support mechanisms.

USAC maintains a Whistleblower Hotline that provides a toll-free phone number for applicants, service providers, and other concerned parties to call attention to circumstances in which universal service funds may have been misapplied or program rules may have been violated. If an investigation confirms a program rule violation, USAC takes immediate corrective steps, including but not limited to adjusting or rescinding funding commitments and recovering program funds. Where appropriate, USAC may refer matters to the FCC and other law enforcement agencies.

USAC is governed by a 19-member Board of Directors representing virtually all USF stakeholders. By FCC requirement, the Board is composed of representatives from a variety of telecommunications service providers, eligible applicant groups, consumer advocates, state regulators, and eligible applicants. Each member of the Board is responsible for the stewardship of USAC and the USF, as well as representing the interests of the member's constituency. Each member is required to comply with a Statement of Ethical Conduct outlining the responsibilities of his or her position.

In October 2002, the Board of Directors established an Audit Committee to provide oversight to the expanded audit activity. Prior to the creation of this committee, the Executive Committee of the Board of Directors held responsibility for the oversight and review of USAC audit activities. The new Audit Committee will provide heightened oversight, focusing even more closely on the conduct and results of USAC's audit activity.

USAC is required to disclose expenses that are reimbursed to Board members for events other than attendance at USAC Board meetings. Two Board members were reimbursed a total of \$3,091.83 in connection with their travels to review the investment and banking operations and to expand outreach activities and improve program administration.



October 2002 Board of Directors quarterly meeting.



## Our Future

On December 13, 2002, the FCC adopted interim measures that modified the USF contribution methodology. The FCC increased, from 15 to 28.5 percent, the minimum percentage that, absent other data, wireless carriers must assume constituted their interstate revenues. The contribution factor is then applied to this percentage. In addition, the FCC directed USAC to base USF contributions on each contributor's projected, collected, end-user interstate revenues, rather than historical, gross-billed revenues. The FCC also ordered that if a carrier chooses to recover the costs of contributing to the USF by adding a line item to its customers' bills, then the carrier is prohibited from including a mark-up above the actual contribution factor set by the FCC. These changes are meant to stabilize the contribution factor for most telecommunications companies and to reduce the costs passed on to consumers.

The FCC has recently referred some important issues to the Federal-State Joint Board on Universal Service to seek the Joint Board's recommendations, which is the first step in the FCC's decision-making with respect to universal service issues. On November 7, 2002, the FCC requested the Joint Board to review the Commission's rules relating to high cost universal service support in areas in which a competitive eligible telecommunications company (ETC) is providing service, as well as the Commission's rules regarding support for secondary lines. In addition, the Joint Board will be looking into the methodology for calculating support for ETCs in competitive study areas. The FCC has also asked the Joint Board to consider several Low Income Support Mechanism issues, including whether the eligibility criteria and application process should be changed for Lifeline and Link Up. The Joint Board has asked the public

for comment on whether the existing eligibility criteria are sufficient, or whether eligibility should be based on income level. The Joint Board is also considering whether the application process should be modified, and whether automatic enrollment could be used to more readily identify low-income households that qualify for Lifeline and Link Up. USAC is prepared to implement any changes the FCC may make to the High Cost and Low Income Support Mechanisms.

In a continued effort to improve the support mechanisms, the FCC initiated rulemaking proceedings in 2002 for both the Schools and Libraries and the Rural Health Care Support Mechanisms, prompting numerous comments and suggestions from applicants, service providers, and other interested parties. In the Schools and Libraries Support Mechanism proceeding, the FCC sought comment on increasing flexibility for applicants within the support mechanism, creating efficiencies for program administration, as well as increasing measures to prevent waste, fraud, and abuse. The Rural Health Care Support Mechanism proceeding solicited commentary on the possible expansion of services and ways of reducing the administrative burden on applicants to the support mechanism. USAC will continue to work with the FCC, as well as applicants and service providers, to simplify the application process for all of the support mechanisms. USAC will also work to maintain its low administrative costs, increase its efforts to reduce waste, fraud, and abuse, and institute electronic applications changes to make it easier for applicants to apply to the program. USAC looks forward to working with all of its stakeholder groups in its outreach efforts in 2003, as we continue our efforts to bring the benefits of universal service to all Americans.

**USAC will continue to work with the FCC, as well as applicants and service providers, to simplify the process for applicants of all of the support mechanisms.**

# Appendix A

## Report of Independent Public Accountants



To the Board of Directors of the  
Universal Service Administrative Company:

We have audited the accompanying statements of financial position of the Universal Service Administrative Company (a Delaware corporation) (the "Company") as of December 31, 2001 and 2000, and the related statements of operations and change in unrestricted net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Universal Service Administrative Company as of December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Roseland, New Jersey  
April 29, 2002

**Universal Service Administrative Company**  
**Statements of Financial Position**  
**December 31, 2001 and 2000 (in thousands)**

	<u>2001</u>	<u>2000</u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents (Note 2)	\$ 2,595	\$ 1,065
Receivable from Federal Universal Service Fund ("USF") (Note 2)	2,304	1,913
Interest receivable	6	4
Prepaid expenses and other current assets	1,352	423
	<hr/> 6,257	<hr/> 3,415
Restricted Net Assets (Note 3):		
Net assets applicable to Federal USF	2,572,476	1,826,841
Total current assets	<hr/> 2,578,733	<hr/> 1,830,246
Fixed Assets, net (Note 2):	<hr/> 1,047	<hr/> 1,812
Total assets	<hr/> <u>\$ 2,579,780</u>	<hr/> <u>\$ 1,832,068</u>
<b>LIABILITIES AND UNRESTRICTED NET ASSETS</b>		
Current Liabilities		
Accounts payable and accrued expenses (Note 2)	\$ 7,304	\$ 5,227
Restricted Net Liabilities (Note 3)		
Net funds held for Federal USF	2,572,476	1,826,841
Total current liabilities	<hr/> 2,579,780	<hr/> 1,832,068
Commitments and Contingencies (Note 5)	-	-
Unrestricted Net Assets		
Total liabilities and unrestricted net assets	<hr/> <u>\$ 2,579,780</u>	<hr/> <u>\$ 1,832,068</u>

The accompanying notes to financial statements are an integral part of these statements.



**Universal Service Administrative Company**  
**Statements of Operations and Change in Unrestricted Net Assets**  
**December 31, 2001 and 2000 (in thousands)**

	<u>2001</u>	<u>2000</u>
Revenue:		
Contract revenue	\$ 39,284	\$ 43,384
	<hr/>	<hr/>
Operating Expenses:		
Contractual expenses (Notes 1 and 5)	30,275	35,438
Personnel and related expenses	3,851	2,832
General and administrative	4,292	4,249
Depreciation and amortization	866	865
	<hr/>	<hr/>
Total operating expenses	39,284	43,384
	<hr/>	<hr/>
Net income	-	-
	<hr/>	<hr/>
Unrestricted net assets, beginning of year	-	-
	<hr/>	<hr/>
Unrestricted net assets, end of year	\$ -	\$ -
	<hr/>	<hr/>

The accompanying notes to financial statements are an integral part of these statements.

**Universal Service Administrative Company**  
**Statements of Cash Flows**  
**For the Years Ended December 31, 2001 and 2000**  
**(in thousands)**

	<u>2001</u>	<u>2000</u>
Cash Flows From Operating Activities:		
Cash received from contributors	\$ 5,238,714	\$ 4,470,043
Interest received	95,934	119,874
Cash paid to service providers	(4,623,594)	(4,386,232)
Cash paid for administrative costs	(37,271)	(36,716)
	<hr/>	<hr/>
Less: Net cash provided by Federal USF	(672,148)	(177,661)
Net cash provided by (used for) operating activities	1,635	(10,692)
Cash Flows From Investing Activities:		
Redemption of short-term investments	2,025,627	573,145
Purchase of short-term investments	(1,495,113)	(962,235)
Cash paid for fixed assets	(105)	(136)
Less: Net cash (provided by) used for Federal USF	(530,514)	389,090
	<hr/>	<hr/>
Net cash used for investing activities	(105)	(136)
Increase (decrease) in cash and cash equivalents	1,530	(10,828)
Cash and cash equivalents, beginning of year	1,065	11,893
	<hr/>	<hr/>
Cash and cash equivalents, end of year	\$ 2,595	\$ 1,065
Reconciliation of Net Cash From Operating Activities:		
Net income	\$ -	\$ -
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	871	865
Changes in operating assets and liabilities:		
Decrease in interest receivable	8	11
(Increase) decrease in prepaid expenses and other current assets	(929)	1,156
(Increase) decrease in restricted net assets applicable to Federal USF	(745,635)	(142,440)
(Increase) in receivable from Federal USF	(391)	(1,913)
(Decrease) in payable to Federal USF	-	(15,362)
Increase in accounts payable and accrued expenses	2,076	4,551
Increase in restricted net funds held for Federal USF	745,635	142,440
	<hr/>	<hr/>
Net cash provided by (used for) operating activities	\$ 1,635	\$ (10,692)

The accompanying notes to financial statements are an integral part of these statements.

# Universal Service Administrative Company

## Notes to Financial Statements

### December 31, 2001 and 2000 (in thousands)

#### 1. Organization and Basis of Presentation

The Universal Service Administrative Company (“USAC” or the “Company”) was incorporated, effective September 17, 1997, as a not for profit independent wholly-owned subsidiary of the National Exchange Carrier Association, Inc. (“NECA”), and appointed by the Federal Communications Commission (“FCC”) to administer the Federal Universal Service Fund (“USF”). USAC’s Board of Directors consists of independent directors representing a cross-section of stakeholders in the Federal USF.

The FCC, in its Report and Order in CC Docket Nos. 96-45 and 97-21 (“Universal Service Order”) released May 8, 1997 and November 20, 1998, respectively, determined that USAC should serve as the permanent administrator of the high cost, low income, rural health care, and schools and libraries universal service support mechanisms, collectively referred to herein as the “Support Mechanisms,” established pursuant to Section 254 of the Communications Act of 1934, as amended.

USAC performs billing, collection and disbursement functions for all the Support Mechanisms. It also collects information regarding contributing entities’ and end-user telecommunications revenues, submits projections of demand, administrative expenses for the Support Mechanisms and quarterly universal service contribution data to the FCC.

The functions of USAC also include, but are not limited to: development of applications and associated instructions as needed for the Support Mechanisms, administering the application process to ensure compliance with FCC rules and regulations, creating and maintaining a web site and related operational infrastructure for such processes, performing outreach and public education functions, authorizing audits of telecommunication carriers, schools, libraries, and rural health care providers, and development and implementation of other functions unique to the Support Mechanisms. Funds collected from contributors by USAC are restricted as to their intended use related to the Support Mechanisms discussed above. Accordingly, such funds, together with related assets and liabilities have been reflected as restricted net assets applicable to Federal USF in the accompanying statements of financial position. Available funds are maintained and invested by USAC.

NECA performs certain administrative services for USAC under contract whereby NECA is compensated by USAC in accordance with NECA’s Cost Accounting and Procedures Manual. Effective July 1, 2000, NECA entered into a fixed price contract with USAC for services performed for the Schools and Libraries and Rural Health Care Support Mechanisms. On July 1, 2001, USAC migrated the billing and collection, disbursement and financial services functions from NECA to another service provider. (See Note 5). For the years ended December 31, 2001 and 2000, the expense recognized for services rendered by NECA were \$28,526 and \$33,796, respectively, and is included in contractual expenses in the accompanying statements of operations. At December 31, 2001, the amounts due to NECA was \$6,115 related to these services.

#### 2. Accounting Policies

##### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The allowance for doubtful accounts represents a reserve estimate for amounts billed to contributors which may be uncollectible. The allowance includes specific reserves for identified bankruptcies and general reserves based on management’s assessment of the recoverability of account receivable. Management periodically reviews such estimates and it is reasonably possible that management’s assessment of recoverability may change based on actual results.

##### CASH AND CASH EQUIVALENTS

USAC considers all highly liquid securities, purchased with an original maturity of three months or less, to be cash equivalents.

##### SHORT-TERM INVESTMENTS

USAC considers all securities purchased with an original

## Universal Service Administrative Company Notes to Financial Statements December 31, 2001 and 2000 (in thousands)

maturity greater than three months but less than or equal to one year to be short-term investments. All short-term investments are classified as held-to-maturity because USAC has the intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. The carrying value of investment securities approximates fair market value because of the short maturity of these investments.

### FIXED ASSETS

Fixed assets consist of furniture, equipment, leasehold improvements and software and are carried at cost. Depreciation of furniture and equipment is calculated on a straight-line basis over the estimated useful lives of those assets (five to seven years). Amortization of leasehold improvements is calculated on a straight-line basis over the remaining period of the respective leases or estimated useful lives of the improvements, whichever is less. Amortization of software is calculated on a straight-line basis over the estimated useful lives of those assets (three years). Maintenance and repairs are charged to operations as incurred.

### ACCOUNTS PAYABLE AND ACCRUED EXPENSES

At December 31, 2001 and 2000, accounts payable and accrued expenses represents costs incurred and recorded by USAC related to the administration of the USF.

### RECEIVABLE FROM USF

Receivable from USF presented on the USAC statement of financial position as of December 31, 2001 and 2000 consists of amounts owed USAC from the USF for accounts payable and accrued expenses incurred by USAC net of assets available to satisfy those obligations.

### CONTRACT REVENUE

USAC recognizes contract revenue when services are rendered. Contract revenues are equal to the cost of providing administrative support to the Support Mechanisms.

### AMOUNTS BILLED TO CONTRIBUTORS

Contributors to the USF are permitted to revise their revenue data, which may result in adjustments to amounts previously billed. In accordance with FCC Rules and Regulations, the Company has recorded these adjustments in current period billings rather than reflecting these adjustments in the period to which they pertain. Management does not believe that the impact of these adjustments is material to the financial

statements presented.

### PAYABLE TO SERVICE PROVIDERS

Payable to service providers reflects amounts that have been approved for payment by the various Support Mechanisms but have not yet been disbursed. The Company recognizes the obligation upon review and approval of the submitted payment requests as specified in the Support Mechanism rules.

### AMOUNTS PAID AND DUE TO SERVICE PROVIDERS

Amounts paid and due to service providers are presented as a gross amount. However, during 2001 and 2000, service providers receiving support from Schools and Libraries Support Mechanism had the option to net their support due from Schools and Libraries Support Mechanism against their payments relating to all four of the Support Mechanisms comprising USF. It is mandatory that providers receiving support from Rural Health Care Support Mechanism net their support due against their payments to USF. There is no provision that enables providers to net their support due from High Cost and Low Income Support Mechanisms against their contributions to USF.

Amounts paid and due to service providers through certain Support Mechanisms are based on estimates and provider data which may be subject to subsequent revisions. These revisions may result in adjustments to amounts previously billed or disbursed. In accordance with FCC Rules and Regulations, the Company records these adjustments in the period they are determined. Management does not believe that the impact of these adjustments is material to the financial statements presented.

### STATEMENTS OF CASH FLOWS

The statements of cash flows include all cash flow activity relating to USAC and the Support Mechanisms.

### 3. Restricted Net Assets and Net Liabilities

In connection with USAC's administration of the Support Mechanisms (Note 1), USAC collects monies and makes disbursements between various telecommunications providers, as specified by the FCC. The following summary statements of net assets applicable to Federal USF, summary statements of activities and summary statements of cash flows are provided for additional information.

Universal Service Administrative Company  
Notes to Financial Statements  
December 31, 2001 and 2000 (in thousands)

SUMMARY STATEMENT OF NET ASSETS APPLICABLE TO FEDERAL USF	2001				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
<b>Assets</b>					
Restricted cash and cash equivalents	\$ 104,825	\$ 53,772	\$ 1,785,425	\$ 7,507	\$ 1,951,529
Short-term investments	-	-	431,723	-	431,723
Receivable from contributors	304,889	53,474	238,284	1,241	597,888
Allowance for doubtful accounts (Note 2)	(53,100)	(12,300)	(40,900)	(530)	(106,830)
Interest receivable	659	739	4,637	24	6,059
<b>Total assets</b>	<b>357,273</b>	<b>95,685</b>	<b>2,419,169</b>	<b>8,242</b>	<b>2,880,369</b>
<b>Liabilities</b>					
Payable to service providers	225,221	49,063	22,071	-	296,355
Payable to contributors	4,766	822	3,622	24	9,234
Payable to USAC	(791)	(287)	3,177	205	2,304
<b>Total liabilities</b>	<b>229,196</b>	<b>49,598</b>	<b>28,870</b>	<b>229</b>	<b>307,893</b>
<b>Net assets applicable to Federal USF</b>	<b>\$ 128,077</b>	<b>\$ 46,087</b>	<b>\$ 2,390,299</b>	<b>\$ 8,013</b>	<b>\$ 2,572,476</b>
SUMMARY STATEMENT OF ACTIVITES	2001				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
<b>Additions</b>					
Amounts billed to contributors	\$ 2,727,169	\$ 573,329	\$ 2,126,245	\$ 10,483	\$ 5,437,226
Interest income	4,044	4,858	63,197	430	10,913
<b>Total additions</b>	<b>2,731,213</b>	<b>578,187</b>	<b>2,189,442</b>	<b>10,913</b>	<b>5,509,755</b>
<b>Deductions</b>					
Amounts paid and due to service providers	2,600,596	577,594	1,465,372	8,428	4,651,990
Refunds paid and due to contributors	-	-	-	-	-
Allowance for doubtful accounts	36,559	7,918	28,120	249	72,846
Operating expenses	5,151	1,394	30,150	2,589	39,284
<b>Total deductions</b>	<b>2,642,306</b>	<b>586,906</b>	<b>1,523,642</b>	<b>11,266</b>	<b>4,764,120</b>
<b>Change in net assets</b>	<b>88,907</b>	<b>(8,719)</b>	<b>665,800</b>	<b>(353)</b>	<b>745,635</b>
<b>Net assets, beginning of year</b>	<b>39,170</b>	<b>54,806</b>	<b>1,724,499</b>	<b>8,366</b>	<b>1,826,841</b>
<b>Net assets, end of year</b>	<b>\$ 128,077</b>	<b>\$ 46,087</b>	<b>\$ 2,390,299</b>	<b>\$ 8,013</b>	<b>\$ 2,572,476</b>

**Universal Service Administrative Company**  
**Notes to Financial Statements**  
**December 31, 2001 and 2000 (in thousands)**

SUMMARY STATEMENT OF NET ASSETS APPLICABLE TO FEDERAL USF	2000				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
<b>Assets</b>					
Restricted cash and cash equivalents	\$ 49,160	\$ 52,035	\$ 640,124	\$ 7,548	\$ 748,867
Short-term investments	-	-	962,235	-	962,235
Receivable from contributors	241,047	56,180	140,438	1,195	438,860
Allowance for doubtful accounts (Note 2)	(16,541)	(4,382)	(12,780)	(281)	(33,984)
Interest receivable	26	28	29,275	5	29,334
<b>Total assets</b>	<b>273,692</b>	<b>103,861</b>	<b>1,759,292</b>	<b>8,467</b>	<b>2,145,312</b>
<b>Liabilities</b>					
Payable to service providers	226,700	47,486	26,341	-	300,527
Payable to contributors	7,979	1,572	6,416	64	16,031
Payable to USAC	(157)	(3)	2,036	37	1,913
<b>Total liabilities</b>	<b>234,522</b>	<b>49,055</b>	<b>34,793</b>	<b>101</b>	<b>318,471</b>
<b>Net assets applicable to Federal USF</b>	<b>\$ 39,170</b>	<b>\$ 54,806</b>	<b>\$ 1,724,499</b>	<b>\$ 8,366</b>	<b>\$ 1,826,841</b>
SUMMARY STATEMENT OF ACTIVITIES	2000				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
<b>Additions</b>					
Amounts billed to contributors	\$ 2,252,041	\$ 530,287	\$ 1,684,713	\$ 9,283	\$ 4,476,324
Interest income	10,023	4,855	111,293	478	126,649
<b>Total additions</b>	<b>2,262,064</b>	<b>535,142</b>	<b>1,796,006</b>	<b>9,761</b>	<b>4,602,973</b>
<b>Deductions</b>					
Amounts paid and due to service providers	2,223,708	522,758	1,651,544	4,911	4,402,921
Refunds paid and due to contributors	210	73	89	1	373
Allowance for doubtful accounts	6,426	1,494	5,783	152	13,855
Operating expenses	4,432	1,348	34,319	3,285	43,384
<b>Total deductions</b>	<b>2,234,776</b>	<b>525,673</b>	<b>1,691,735</b>	<b>8,349</b>	<b>4,460,533</b>
<b>Change in net assets</b>	<b>27,288</b>	<b>9,469</b>	<b>104,271</b>	<b>1,412</b>	<b>142,440</b>
<b>Net assets, beginning of year</b>	<b>11,882</b>	<b>45,337</b>	<b>1,620,228</b>	<b>6,954</b>	<b>1,684,401</b>
<b>Net assets, end of year</b>	<b>\$ 39,170</b>	<b>\$ 54,806</b>	<b>\$ 1,721,499</b>	<b>\$ 8,366</b>	<b>\$ 1,826,841</b>

Universal Service Administrative Company  
Notes to Financial Statements  
December 31, 2001 and 2000 (in thousands)

SUMMARY STATEMENT OF CASH FLOWS	2001				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
Cash Flows from Operating Activities					
Cash received from contributors	\$ 2,662,934	\$ 575,891	\$ 1,989,194	\$ 10,695	\$ 5,238,714
Cash paid to service providers	(2,605,066)	(576,526)	(1,433,266)	(8,736)	(4,623,594)
Cash paid to USAC for administrative expenses	(5,622)	(1,778)	(28,827)	(2,396)	(38,623)
Interest received	3,419	4,150	87,686	396	95,651
Intraprogram loans	-	-	-	-	-
Net cash provided by (used for) operating activities	55,665	1,737	614,787	(41)	672,148
Cash Flows from Operating Activities					
Redemption of short-term investments	-	-	2,025,627	-	2,025,627
Purchase of short-term investments	-	-	(1,495,113)	-	(1,495,113)
Net cash provided by (used for) investing activities	-	-	530,514	-	530,514
Cash Flows from Financing Activities					
Increase (decrease) in cash and cash equivalents	-	-	-	-	-
	55,665	1,737	1,145,301	(41)	1,202,662
Cash and Cash Equivalents, beginning of year	49,160	52,035	640,124	7,548	748,867
Cash and Cash Equivalents, end of year	\$ 104,825	\$ 53,772	\$ 1,785,425	\$ 7,507	\$ 1,951,529

Universal Service Administrative Company  
Notes to Financial Statements  
December 31, 2001 and 2000 (in thousands)

SUMMARY STATEMENT OF CASH FLOWS	2000				
	High Cost	Low Income	Schools & Libraries	Rural Health Care	Total USF
Cash Flows from Operating Activities					
Cash received from contributors	\$ 2,819,613	\$ 520,047	\$ 1,751,254	\$ 9,129	\$ 4,470,043
Cash paid to service providers	(2,140,410)	(553,528)	(1,686,415)	(4,879)	(4,386,282)
Cash paid to USAC for administrative expenses	(2,262)	(901)	(19,602)	(2,865)	(25,630)
Interest received	10,152	5,774	103,099	455	119,480
Intraprogram loans	(7,377)	7,377	-	-	-
Net cash provided by (used for) operating activities	48,716	(21,231)	148,336	1,840	177,661
Cash Flows from Operating Activities					
Redemption of short-term investments	-	-	573,145	-	573,145
Purchase of short-term investments	-	-	(962,235)	-	(962,235)
Net cash provided by (used for) investing activities	-	-	(389,090)	-	(389,090)
Cash Flows from Financing Activities					
Increase (decrease) in cash and cash equivalents	-	-	-	-	-
	48,716	(21,231)	(240,754)	1,840	(211,429)
Cash and Cash Equivalents, beginning of year	444	73,266	880,878	5,708	960,296
Cash and Cash Equivalents, end of year	\$ 49,160	\$ 52,035	\$ 640,124	\$ 7,548	\$ 748,867



**Universal Service Administrative Company**  
**Notes to Financial Statements**  
**December 31, 2001 and 2000 (in thousands)**

**4. INCOME TAXES**

USAC is a not-for-profit organization subject to income taxes related to permanent and temporary differences such as meals and entertainment expense and financial accounting versus tax depreciation. Income taxes for the 2001 and 2000 period are not material and are included as a component of administrative costs.

**5. COMMITMENTS AND CONTINGENCIES**

**COMMITMENTS TO SCHOOLS, LIBRARIES AND RURAL HEALTH CARE FACILITIES**

The management of USAC has developed operational procedures to administer the application process through which eligible schools and libraries and rural health care providers apply for universal service funding. These operational procedures enable USAC to review and process applications resulting in funding commitment letters that are issued to eligible schools and libraries and rural health care providers. Funding commitments made to eligible schools and libraries and rural health care providers are not fixed and are not binding for either USAC or the schools and libraries and rural health care providers applying for funding. At any point in time, funds committed could potentially exceed funds available due to the nature of the process, the volume and timing of application receipt and approval, the timing of collections and the extent to which several funding years may be open at that point in time. USAC also receives funds returned by service providers and applies those funds to reduce the disbursements against commitments to schools, libraries, and rural health care providers.

**FIXED CONTRACT COMMITMENTS**

On May 1, 2000, USAC entered into an agreement with NECA ("NECA Agreement"). The NECA Agreement is a three year contract, which runs from July 1, 2000 to June 30, 2003. Under the terms of this agreement NECA is to provide programmatic support service to the Schools and Libraries and Rural Health Care Support Mechanisms. The future contractual required

payments per year under the NECA Agreement are as follows:

	Schools and Libraries	Rural Health Care
2002	\$ 19,765	\$ 1,883
2003	10,780	961

On May 10, 2001, USAC entered into separate agreements with PricewaterhouseCoopers, LLP ("PwC Agreement") for billing, collection and disbursement services for USAC. The PwC agreement is a five year contract which runs from July 1, 2001 to June 30, 2006. The future contractual required payments per year under the PwC Agreement are as follows:

2002	\$3,370
2003	3,437
2004	3,582
2005	3,714
2006	1,882

On May 1, 2001, USAC entered into an agreement with LaSalle Bank ("LaSalle Agreement"). The LaSalle Agreement is a five year contract which runs from July 1, 2001 to June 30, 2006. Under the terms of the LaSalle Agreement, LaSalle provides banking and investment management services for a fixed annual contractual amount which may be satisfied by fees derived by LaSalle from the investment of a portion of the custodial assets. LaSalle has also agreed to share with USAC the fees it earns for managing the investments after the annual fee has been satisfied. In 2001, USAC accrued \$984 of income in accordance with the LaSalle Agreement which is reflected as a reduction in operating expenses in the accompanying financial statements. The fees earned are dependent on the amount invested and will vary over the term of the contract.

The future contractual required payments per year under the LaSalle Agreement are as follows:

2002	\$ 950
2003	950
2004	974
2005	1,027
2006	528

**Universal Service Administrative Company**  
**Notes to Financial Statements**  
**December 31, 2001 and 2000 (in thousands)**

LEASE COMMITMENTS

USAC leases office space under terms of two operating leases. One lease expires in 2002. The other lease expires in 2003 and provides for an escalation clause, the effect of which is not expected to be significant. Net rent expense relating to premises, amounted to \$288 in 2001, and \$287 in 2000. At December 31, 2001, the minimal annual rental and equipment commitments under these leases are as follows:

2002	\$ 334
2003	<u>337</u>
	\$ 671

LEGAL DISPUTES

USAC is involved in various legal proceedings and claims incidental to the normal conduct of its business. Although it is impossible to predict the outcome of any outstanding legal proceedings, the Company believes that such outstanding legal proceedings and claims, individually and in the aggregate, are not likely to have a material effect on its financial position or results of operations.

In 1999 and 2000, NECA was subject to a dispute with a

systems vendor that was resolved in 2001. The services performed by the systems vendor were contracted by NECA pursuant to a subcontract between NECA and the systems vendor, in relation to a service agreement between NECA and USAC that terminated in June 1999. In 2001, USAC and NECA agreed to amend the fixed price of their current services agreement for the Schools and Libraries and Rural Health Care Support Mechanisms to accommodate unanticipated increases in forms and appeals volumes. This contract modification facilitated NECA's resolution of the dispute with its systems vendor.

6. Retirement Plans

USAC has a 401(k) Retirement Savings Plan covering all USAC regular employees. The plan is both contributory and noncontributory and all contributions are subject to certain limitations as prescribed by the plan document and government regulations. Employees are immediately vested in the employer contribution, which is funded on a current basis. Employer contributions charged to operations was \$298 and \$175 during 2001 and 2000, respectively.

# Appendix B

## Detailed Charts

### Disbursements by Service Provider Type, 2002 (Disbursements in thousands)

SERVICE PROVIDER TYPE	HIGH COST	LOW INCOME	RURAL HEALTH CARE	SCHOOLS AND LIBRARIES	TOTAL 2002
Competitive Access Provider	\$ 2,939	\$ 2,198	\$ 1,005	\$ 94,595	\$ 100,737
Cellular/PCS Providers	44,808	9,932	---	24,724	79,464
Wireless Data Providers	---	---	---	13,781	13,781
Internet Service Providers	---	---	---	98,387	98,387
Interexchange Providers	---	---	12,369	61,423	73,792
Local Exchange Carriers	2,930,209	660,931	2,573	512,827	4,106,539
Local Resellers	---	---	---	11,701	11,701
Non-Traditional Providers	---	---	---	796,699	796,699
Operator Service Providers	---	---	---	19	19
Other Local	---	---	29	9,615	9,644
Other Mobile	---	---	---	28	28
Other Toll	---	---	310	8	318
Paging and Messaging	---	---	17	1,537	1,544
Payphone Service Providers	---	---	---	130	130
Pre-Paid Card Providers	---	---	---	17	17
Private Service Providers	---	---	4	33,796	33,800
Satellite Service Providers	---	---	---	592	592
Specialized Mobile Service Providers	---	---	---	413	413
Shared Tenant Service Providers	---	---	---	130	130
Toll Resellers	---	---	110	21,343	21,453
Not Specified	---	---	---	901	901
<b>Total</b>	<b>\$ 2,977,955</b>	<b>\$ 673,061</b>	<b>\$ 16,417</b>	<b>\$ 1,682,664</b>	<b>\$ 5,350,097</b>

## High Cost Support by State (Disbursements in thousands)

STATE	TOTAL RURAL	TOTAL NON-RURAL	2002 SUPPORT	TOTAL (1998 - 2002)
Alabama	\$ 33,993	\$ 66,175	\$ 100,168	\$ 357,354
Alaska	81,080	147	81,226	358,800
American Samoa	688	0	688	2,024
Arizona	52,901	14,063	66,964	217,600
Arkansas	96,694	4,763	101,457	393,099
California	38,803	26,595	65,398	336,082
Colorado	48,637	19,931	68,569	269,107
Connecticut	18,783	544	19,327	5,831
Delaware	1,141	378	1,519	964
District of Columbia	0	0	0	0
Florida	13,345	65,845	79,190	262,654
Georgia	68,525	13,196	81,720	426,533
Guam	39,328	0	39,328	12,075
Hawaii	4,398	2,258	6,656	18,084
Idaho	40,228	0	40,228	186,656
Illinois	27,343	10,682	38,025	181,116
Indiana	33,611	20,846	54,457	153,858
Iowa	31,503	508	32,012	161,480
Kansas	89,481	1,398	90,880	369,517
Kentucky	53,668	22,762	76,430	167,591
Louisiana	65,260	10,320	75,579	373,438
Maine	34,855	5,828	40,682	130,582
Maryland	16,405	3,587	19,992	12,749
Massachusetts	1,135	128	1,263	5,295
Michigan	26,454	68	26,523	192,848
Minnesota	48,444	1,491	49,935	245,697
Mississippi	57,507	142,170	199,678	500,232
Missouri	62,260	8,410	70,671	326,451
Montana	53,551	11,138	64,689	246,088
Nebraska	35,482	723	36,205	124,000
Nevada	29,759	4,154	33,913	83,187
New Hampshire	10,051	3,452	13,503	45,754
New Jersey	6,989	2,250	9,239	17,537
New Mexico	26,392	2,862	29,254	193,150
New York	36,756	12,248	49,004	243,281
North Carolina	37,120	22,984	60,104	199,607
North Dakota	32,078	2,817	34,895	129,597
Northern Mariana Islands	21,709	0	21,709	20,424
Ohio	19,449	15,220	34,669	112,375
Oklahoma	84,093	5,391	89,484	350,165
Oregon	48,164	19,498	67,662	246,424
Pennsylvania	42,759	3,098	45,858	154,146
Puerto Rico	0	97,687	97,687	627,848
Rhode Island	0	59	59	181
South Carolina	56,146	13,344	69,491	258,536
South Dakota	33,884	73	33,956	116,938
Tennessee	42,125	6,776	48,900	179,463
Texas	155,580	32,243	187,823	734,785
Utah	17,353	1,285	18,638	65,592
Vermont	14,718	11,123	25,841	97,546
Virgin Islands	31,792	0	31,792	122,485
Virginia	16,101	55,415	71,516	198,552
Washington	61,881	17,349	79,230	294,969
West Virginia	39,819	41,686	81,505	263,843
Wisconsin	69,503	1,136	70,639	283,702
Wyoming	26,540	15,584,028	42,124	155,776
TOTAL	\$ 2,136,267	\$ 841,688	\$ 2,977,955	\$ 11,233,669

## High Cost Support by Component, 2002 (Disbursements in thousands)

STATE	HIGH COST LOOP	INTERSTATE ACCESS	LONG TERM	LOCAL SWITCHING	ICLS	TOTAL 2002 SUPPORT
Alabama	\$ 58,947	\$ 24,088	\$ 7,596	\$ 6,699	\$ 2,836	\$ 100,168
Alaska	44,488	0	17,623	14,018	5,097	81,226
American Samoa	0	0	268	396	24	688
Arizona	26,401	20,882	3,286	13,748	2,648	66,964
Arkansas	62,543	4,763	15,302	7,657	11,192	101,457
California	32,375	32,330	0	693	0	65,398
Colorado	31,439	15,782	12,985	5,460	2,903	68,569
Connecticut	0	544	12,644	4,186	1,954	19,327
Delaware	0	378	169	846	126	1,519
District of Columbia	0	0	0	0	0	0
Florida	13,221	65,968	0	0	0	79,190
Georgia	56,435	13,457	5,407	4,156	2,265	81,720
Guam	0	0	18,507	13,403	7,419	39,328
Hawaii	2,072	2,258	2,327	0	0	6,656
Idaho	20,685	14,877	82	2,169	2,415	40,228
Illinois	12,022	13,069	3,590	7,169	2,174	38,025
Indiana	6,793	24,018	6,125	12,798	4,723	54,457
Iowa	8,650	6,838	5,311	8,523	2,690	32,012
Kansas	53,316	8,312	7,504	14,852	6,895	90,880
Kentucky	24,548	20,121	11,838	12,260	7,662	76,430
Louisiana	50,898	10,320	5,014	5,227	4,121	75,579
Maine	13,738	363	17,095	6,553	2,934	40,682
Maryland	201	3,587	6,128	8,143	1,933	19,992
Massachusetts	239	128	95	511	290	1,263
Michigan	25,326	238	106	689	164	26,523
Minnesota	25,155	4,415	10,136	8,201	2,027	49,935
Mississippi	139,773	21,611	12,597	17,640	8,057	199,678
Missouri	45,523	14,631	5,250	3,292	1,975	70,671
Montana	39,155	656	10,983	5,714	8,181	64,689
Nebraska	11,251	2,623	10,389	7,807	4,135	36,205
Nevada	6,883	8,283	3,984	10,282	4,481	33,913
New Hampshire	975	3,452	965	6,981	1,130	13,503
New Jersey	0	2,580	1,525	4,593	541	9,239
New Mexico	20,003	7,852	0	1,399	0	29,254
New York	12,078	19,558	6,419	8,713	2,237	49,004
North Carolina	11,532	22,984	6,793	17,118	1,677	60,104
North Dakota	13,018	689	12,110	5,329	3,750	34,895
Northern Mariana Islands	2,656	250	6,211	8,260	4,332	21,709
Ohio	7,915	15,017	5,398	4,514	1,825	34,669
Oklahoma	43,323	5,391	16,887	17,970	5,913	89,484
Oregon	25,604	21,733	9,593	7,957	2,775	67,662
Pennsylvania	1,555	16,029	14,605	6,108	7,561	45,858
Puerto Rico	1,183	0	95,186	0	1,318	97,687
Rhode Island	0	59	0	0	0	59
South Carolina	29,464	15,718	11,006	4,343	8,960	69,491
South Dakota	13,712	84	5,274	10,851	4,035	33,956
Tennessee	17,627	7,740	10,788	9,041	3,704	48,900
Texas	94,623	39,513	29,298	17,067	7,322	187,823
Utah	6,517	2,309	1,545	5,532	2,735	18,638
Vermont	14,956	1,986	2,479	4,764	1,655	25,841
Virgin Islands	18,472	0	7,480	0	5,841	31,792
Virginia	4,190	55,980	3,465	6,348	1,533	71,516
Washington	31,454	23,671	14,457	7,455	2,192	79,230
West Virginia	55,610	20,198	1,102	4,026	570	81,505
Wisconsin	21,970	1,384	13,220	23,556	10,510	70,639
Wyoming	23,521	6,472	4,672	6,123	1,336	42,124
TOTAL	\$ 1,284,034	\$ 625,188	\$ 492,819	\$ 391,142	\$ 184,772	\$ 2,977,955

## Low Income Support by Component, 2002 (Disbursements in thousands)

STATE	LIFELINE	LINK-UP	TOLL LIMITATION	2002 SUPPORT	TOTAL 1998-2002	
Alabama	\$ 2,674	\$ 22	\$ 9	\$ 2,705	10,054	
Alaska	2,326	82	63	2,472	5,125	
American Samoa	56	1	0	57	197	
Arizona	11,008	374	174	11,556	21,547	
Arkansas	921	112	13	1,045	3,869	
California	292,588	18,517	2,503	313,608	1,453,086	
Colorado	3,238	11	33	3,282	12,375	
Connecticut	5,371	118	9	5,499	24,053	
Delaware	224	18	0	242	486	
District of Columbia	1,212	0	0	1,212	4,939	
Florida	15,188	294	40	15,521	63,335	
Georgia	7,236	93	34	7,364	33,541	
Guam	320	24	2	346	860	
Hawaii	1,227	134	0	1,361	5,775	
Idaho	3,023	15	29	3,067	9,328	
Illinois	7,731	946	43	8,720	25,890	
Indiana	3,590	511	1	4,103	10,958	
Iowa	1,540	42	20	1,602	4,082	
Kansas	1,434	67	2	1,503	4,556	
Kentucky	5,293	163	45	5,501	16,372	
Louisiana	1,836	36	4	1,876	5,594	
Maine	9,167	596	16	9,779	37,813	
Maryland	420	2	0	422	1,887	
Massachusetts	17,589	21	0	17,611	76,637	
Michigan	11,359	592	7	11,958	56,739	
Minnesota	3,929	6	9	3,945	18,497	
Mississippi	2,395	18	4	2,417	7,952	
Missouri	2,979	153	20	3,153	8,940	
Montana	1,679	31	36	1,745	5,631	
Nebraska	1,605	31	37	1,673	5,870	
Nevada	3,347	102	15	3,464	8,093	
New Hampshire	630	9	0	639	2,193	
New Jersey	4,640	42	0	4,682	11,242	
New Mexico	5,208	53	91	5,352	18,279	
New York	51,679	1,486	11	53,175	263,138	
North Carolina	10,786	69	36	10,891	31,079	
North Dakota	1,953	39	17	2,009	6,353	
Northern Mariana Islands	36	6	0	43	175	
Ohio	25,145	1,033	89	26,267	75,233	
Oklahoma	12,483	293	75	12,851	20,860	
Oregon	3,992	78	22	4,093	15,050	
Pennsylvania	9,364	1,058	0	10,422	28,674	
Puerto Rico	6,463	156	0	6,619	10,670	
Rhode Island	4,926	8	0	4,933	21,388	
South Carolina	2,380	37	25	2,442	9,881	
South Dakota	3,454	382	38	3,874	8,100	
Tennessee	5,153	120	30	5,304	17,701	
Texas	44,118	1,362	112	45,592	145,238	
Utah	2,110	10	26	2,146	9,317	
Vermont	3,193	30	6	3,229	13,541	
Virgin Islands	0	0	0	0	140	
Virginia	2,044	14	1	2,059	10,081	
Washington	9,294	697	113	10,104	35,502	
West Virginia	461	6	5	473	2,083	
Wisconsin	6,190	586	5	6,780	25,602	
Wyoming	270	2	3	275	801	
28	TOTAL	\$ 638,480	\$ 30,709	\$ 3,872	\$ 673,061	\$ 2,726,403

## Rural Health Care Support by State (Disbursements in thousands)

STATE	2002 SUPPORT	TOTAL 1998-2002
Alabama	\$ 12	\$ 21
Alaska	11,817	17,939
American Samoa	0	0
Arizona	269	1,082
Arkansas	60	225
California	131	365
Colorado	91	261
Connecticut	0	0
Delaware	0	0
District of Columbia	0	0
Florida	2	2
Georgia	6	6
Guam	0	0
Hawaii	201	614
Idaho	82	140
Illinois	63	283
Indiana	0	0
Iowa	134	338
Kansas	219	536
Kentucky	130	164
Louisiana	0	12
Maine	19	19
Maryland	0	0
Massachusetts	0	0
Michigan	382	838
Minnesota	363	1,125
Mississippi	35	117
Missouri	52	161
Montana	494	1,097
Nebraska	573	1,177
Nevada	22	80
New Hampshire	22	54
New Jersey	0	0
New Mexico	142	431
New York	1	126
North Carolina	161	349
North Dakota	238	905
Northern Mariana Islands	0	0
Ohio	1	76
Oklahoma	97	145
Oregon	25	71
Pennsylvania	4	53
Puerto Rico	0	0
Rhode Island	0	0
South Carolina	9	50
South Dakota	195	469
Tennessee	18	34
Texas	100	222
Utah	36	66
Vermont	0	5
Virgin Islands	1	92
Virginia	44	127
Washington	76	161
West Virginia	6	33
Wisconsin	31	54
Wyoming	52	119
TOTAL	\$ 16,417	\$ 30,247

## Schools and Libraries Support by State (Disbursements in thousands)

STATE	2002 SUPPORT	TOTAL 1998-2002
Alabama	\$ 17,896	\$ 98,647
Alaska	10,802	38,546
American Samoa	1,572	9,137
Arizona	39,460	140,272
Arkansas	12,396	43,302
California	266,611	905,339
Colorado	12,710	43,823
Connecticut	18,382	92,530
Delaware	1,105	4,425
District of Columbia	8,483	23,509
Florida	44,987	185
Georgia	49,138	208,001
Guam	2,282	2,487
Hawaii	1,727	11,354
Idaho	3,078	12,367
Illinois	50,001	354,354
Indiana	14,991	61,670
Iowa	5,826	21,086
Kansas	7,783	34,742
Kentucky	16,872	112,248
Louisiana	24,281	113,746
Maine	4,840	11,704
Maryland	9,956	57,821
Massachusetts	30,114	111,128
Michigan	52,976	209,908
Minnesota	18,957	73,873
Mississippi	24,831	91,078
Missouri	25,614	121,973
Montana	3,368	11,879
Nebraska	5,992	19,910
Nevada	3,172	11,815
New Hampshire	971	3,738
New Jersey	31,264	146,371
New Mexico	38,302	88,370
New York	300,502	837,568
North Carolina	29,780	105,652
North Dakota	2,673	7,977
Northern Mariana Islands	2,028	2,148
Ohio	53,302	195,265
Oklahoma	26,564	100,341
Oregon	9,830	31,163
Pennsylvania	70,124	208,539
Puerto Rico	4,907	114,577
Rhode Island	3,553	19,063
South Carolina	34,235	124,227
South Dakota	5,542	10,152
Tennessee	33,213	154,014
Texas	171,818	519,478
Utah	4,630	18,526
Vermont	1,254	4,639
Virgin Islands	5,324	10,097
Virginia	20,179	78,878
Washington	15,605	73,268
West Virginia	5,026	18,770
Wisconsin	20,660	93,260
Wyoming	1,156	5,858
TOTAL	\$ 1,682,664	\$ 6,209,788



## Schools and Libraries Support by Discount Band, 2002 (Disbursements in thousands)

DISCOUNT BAND	INTERNAL CONNECTIONS	INTERNET ACCESS	TELECOM SERVICES	TOTAL	PERCENT OF TOTAL
20 - 29%	\$ 54	\$ 383	\$ 1,257	\$ 1,694	0.10%
30 - 39%	217	775	6,344	7,337	0.44%
40 - 49%	6,023	19,239	73,952	99,214	5.90%
50 - 59%	2,551	21,062	80,369	103,983	6.18%
60 - 69%	5,929	43,090	104,694	153,714	9.14%
70 - 79%	4,054	29,237	127,322	160,613	9.55%
80 - 89%	224,621	33,696	135,741	394,057	23.42%
90%	716,331	15,303	30,417	762,052	45.29%
Total	\$ 959,780	\$ 162,787	\$ 560,097	\$ 1,682,664	100.00%
Percent of Total	57.04%	9.67%	33.29%	100.00%	

## Rural/Urban Statistics, 2002 (Disbursements in thousands)

RURAL/URBAN STATUS	NUMBER OF APPLICATIONS	PERCENT OF APPLICATIONS	AMOUNT	PERCENT OF TOTAL
Rural	4,098	12.87%	\$ 619,719	36.83%
Urban	14,032	44.08%	775,893	46.11%
N/A	13,702	43.04%	287,053	17.06%
Total	31,832	100.00%	\$ 1,682,664	100.00%

## Applicant Type (Disbursements in thousands)

APPLICANT TYPE	NUMBER OF APPLICATIONS	PERCENT OF APPLICATIONS	AMOUNT	PERCENT OF TOTAL
School District	34,753	59.87%	\$ 1,370,970	81.48%
Library/Library Consortium	8,254	14.22%	51,966	3.09%
School Consortium	12,455	21.46%	107,013	6.36%
Total	58,044	100.00%	\$1,682,664	100.00%

# USAC Board of Directors, 2002



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Executive Director  
National School Boards Association  
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Public Policy Consultant  
Verizon Communications

## Corporate Information

Universal Service Administrative Company  
2120 L St. NW, Suite 600  
Washington, DC 20037

Tel. (202) 776-0200  
(888) 641-8722  
Fax (202) 776-0080  
Website: <http://www.universalservice.org>

## Program Information

### High Cost Support Mechanism

High Cost/Low Income Division  
80 S. Jefferson Rd.  
Whippany, NJ, 07981

Tel. (202) 776-0200  
Website: <http://www.universalservice.org/hc/>

### Low Income Support Mechanism

High Cost/Low Income Division  
80 S. Jefferson Rd.  
Whippany, NJ, 07981

Tel. (202) 776-0200  
Website: <http://www.universalservice.org/li/>

### Rural Health Care Support Mechanism

Rural Health Care Division  
80 S. Jefferson Rd.  
Whippany, NJ, 07981

Tel. (800) 229-5476  
E-mail: [rhc-admin@universalservice.org](mailto:rhc-admin@universalservice.org)  
Website: <http://www.rhc.universalservice.org>

### Schools and Libraries Support Mechanism

Schools and Libraries Division  
P.O. Box 7026  
Lawrence, KS 66044-7026

Tel. (888) 203-8100  
Fax: (888) 276-8736  
E-Mail: [questions@universalservice.org](mailto:questions@universalservice.org)  
Website: <http://www.sl.universalservice.org>

## USAC Billing and Disbursement

Universal Service Administrative Company  
Attn: Billing & Disbursement  
P.O. Box 223164  
Chantilly, VA 20153-3164

Tel. (703) 322-5100  
Fax: (703) 322-3200  
E-Mail: [B&D@universalservice.org](mailto:B&D@universalservice.org)



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